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LOUISIANA PUBLIC SERVICE COMMISSION, *Appellant*
v.
FEDERAL COMMUNICATIONS COMMISSION and
UNITED STATES OF AMERICA

CALIFORNIA AND PUBLIC UTILITIES COMMISSION
OF CALIFORNIA, *et al.*, *Petitioners*
v.
FEDERAL COMMUNICATIONS COMMISSION and
UNITED STATES OF AMERICA

PUBLIC UTILITIES COMMISSION OF OHIO, *et al.*, *Petitioners*
v.
FEDERAL COMMUNICATIONS COMMISSION and
UNITED STATES OF AMERICA

FLORIDA PUBLIC SERVICE COMMISSION, *Petitioner*
v.
FEDERAL COMMUNICATIONS COMMISSION and
UNITED STATES OF AMERICA

On Appeal and On Writs of Certiorari to the United States Court of Appeals for the Fourth Circuit

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BRIEF AMICUS CURIAE OF MCI TELECOMMUNICATIONS CORPORATION

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BRIEF AMICUS CURIAE OF MCI TELECOMMUNICATIONS CORPORATION

INTEREST OF AMICUS CURIAE

MCI Telecommunications Corporation ("MCI"), pursuant to Rule 36 of the Rules of this Court, respectfully submits this brief as amicus curiae in support of respondents the Federal Communications Commission ("FCC" or "the Commission") and the United States of America. Counsel for all parties have consented to the filing of this brief.

MCI is the nation's second largest long-distance telecommunications carrier, providing both interstate and intrastate service. As a common carrier, MCI is subject to the jurisdiction of the FCC under the Communications Act of 1934 and of state regulators in those states where MCI is authorized to offer intrastate service.

In 1969, the FCC authorized MCI to offer communications services between St. Louis and Chicago by means of microwave transmission. Since then, MCI has grown into a multi-billion dollar company which provides a full range of telecommunications services to both residential and business customers in competition with AT&T Communications. MCI is the product of federal policies that promote technological innovation and open competition.

MCI has a direct interest in supporting the FCC's preemptive authority to further the federal policies of modernization and competition as the telecommunications industry enters a new era. This Court's delineation of the FCC's preemptive authority could well have far-reaching effects on

industry trends and regulation of carriers in areas other than depreciation.

MCI also has a specific interest in the local telephone companies' adoption of more accurate depreciation procedures for interstate and intrastate assets. As a long distance carrier, MCI relies upon local telephone companies for access to its customers at both the origination and termination ends of a call.[1] As a major purchaser of "access" from local telephone companies, MCI, like other customers, will be harmed if telephone facilities are allowed to become obsolete due to disincentives created by outmoded depreciation policies. For example, the inferior access that MCI receives from telephone companies through older mechanical "step-by-step" switches — and that MCI's customers experience in the form of extra digits to dial or extraneous background noise or echo — may be substantially improved by the telephone company's installation of electronic switches. To the extent that the equal access provisions of the Modified Final Judgment do not require such improvements,[2] depreciation policies directly affect telephone company incentives to replace older switches.

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[1]A long distance call originates at the caller's instrument and is carried over local telephone company equipment to MCI's terminal. MCI's network then transmits the call to MCI's terminal in the destination city, where it is handed off to the local telephone company at the terminating end, which completes the call to the called party. MCI (and other long distance carriers) must pay "access charges" to the local telephone companies for use of their facilities at the originating and terminating ends of each call.

[2]Appendix to *United States v. American Tel. and Tel. Co.*, 552 F. Supp. 131, 233 (D.D.C. 1982), *aff'd sub nom. Maryland v. United States*, 460 U.S. 1001 (1983) ("Modified Final Judgment" or "MFJ"). Under the MFJ, the Bell Operating Companies must provide to AT&T's competitors access equal in type and quality to that provided AT&T according to a specified timetable. There are exceptions for "nonconforming end offices" (those with less than 10,000 access lines or with switches antecedent to electronic stored program control switches), which collectively account for some 20% of total telephone lines. Moreover, the MFJ's equal access timetable does not apply to independent telephone companies, *i.e.* those in which AT&T never had a majority interest. *See MTS and WATS Market Structure Policies and Requirements*, 50 Fed. Reg. 15,547 (1985) (to be codified at 47 C.F.R. Ch. 1).

SUMMARY OF ARGUMENT

The Communications Act of 1934, 47 U.S.C. §§ 151-609 (1982) (the "Act"), establishes as a federal goal "rapid, efficient, Nation-wide" communications services with "adequate facilities." 47 U.S.C. § 151 (1982). To achieve that goal, the FCC has adopted policies promoting modernization and efficient use of technology. In recent years, dramatic advances in technology have propelled the telecommunications industry far beyond traditional "plain old telephone service." High-speed digital transmission of voice and data is now possible by means of new technologies (*e.g.*, fiber optics). New services (such as computer-to-computer links and cellular radio) are becoming widely available. Competition — and the resulting lower costs and wider range of services — have revitalized the communications industry and contributed to its explosive growth.

Improper regulation can slow the introduction of new technologies and innovative services. State and federal regulators can control the rate of modernization through their power over depreciation rates, which govern the rate of replacement of assets. The original depreciation regulations adopted by the FCC and the States were designed for a monopoly era characterized by slow technological change. Regulators chose to keep local rates low at the expense of slower capital recovery and inflated book values.

The slow depreciation policies traditional in telephony are not appropriate in an era of rapid technological innovation and competition — both of which shorten the useful economic lives of telephone assets. Indeed, those policies create artificial disincentives to modernization and efficiency. When the rate of recovery of capital investment is much slower than the rate of consumption of assets, replacement of obsolete equipment is artificially restrained.

The FCC has attempted to remove these artificial disincentives by adopting more accurate depreciation procedures. It determined that the short-term benefits of slow depreciation (*i.e.*, lower rates) were outweighed by the possibly disastrous

long-term costs of outdated telephone company plant and overstated book values. The federal objective to remove disincentives to modernization and efficiency could not be achieved unless the FCC asserted its preemptive authority over inconsistent state depreciation schedules. If application of the more accurate federal procedures were limited to the portion of telephone property assigned to the FCC's jurisdiction (ranging from 10% to 25%), and the States continued to stretch out depreciation periods for the remaining portion, disincentives to modernization would continue. That is because it is impossible to replace only the interstate-assigned portion of an asset. The business decision to replace and modernize equipment necessarily rests on the total amount of unrecovered investment. In short, without the application of accurate depreciation procedures to *both* interstate and intrastate property, the FCC's efforts would be futile.

Preemption of state depreciation policies does not violate Congress' reservation to the States of intrastate ratemaking authority. The legislative history of Section 220 of the Act, which governs depreciation procedures, reveals that Congress specifically rejected an amendment that would have prohibited preemption. Moreover, the States' authority over plant used jointly for intrastate and interstate communications must be interpreted consistently with the Act's broad purpose that a single regulatory authority coordinate nationwide communications services. Finally, although the FCC's preemptive decision removes disincentives to modernization which threaten the interstate (as well as the intrastate) network, the FCC has not interfered with the States' flexibility to mitigate, through judicious use of their ratemaking authority, the effects of short-term increases in depreciation expenses.

ARGUMENT

I. The FCC's Decision Meets This Court's Preemption Test in *de la Cuesta*.

The Communications Act of 1934 establishes a broad federal goal to ensure a "rapid, efficient, Nation-wide" communica-

tions service, and confers expansive powers on the FCC to achieve this goal. 47 U.S.C. § 151 (1982). Although the Act reserves certain areas of authority to the States, the federal agency may exercise preemptive powers "[e]ven where Congress has not completely displaced state regulation in a specific area . . . to the extent that [the state law] actually conflicts with federal law." *Fidelity Federal Savings and Loan Association v. de la Cuesta*, 458 U.S. 141, 153 (1982).

This Court recently restated the test for review of an agency's decision to preempt:

> When the administrator promulgates regulations intended to pre-empt state law, the court's inquiry is . . . limited: "If [h]is choice represents a reasonable accommodation of conflicting policies that were committed to the agency's care by the statute, we should not disturb it unless it appears from the statute or its legislative history that the accommodation is not one that Congress would have sanctioned."

Capital Cities Cable, Inc. v. Crisp, 104 S.Ct. 2694, 2700 (1984), quoting *de la Cuesta*, 458 U.S. at 153-54, and *United States v. Shimer*, 367 U.S. 374, 383 (1961). The Fourth Circuit properly applied this test in reviewing the FCC's decision. *Virginia State Corporation Commission v. FCC*, 737 F.2d 388, 393 (4th Cir. 1984).

Because there is no dispute in this case that the FCC intended to preempt inconsistent state depreciation regulations, review should focus on the following issues:

(1) whether the specific policies at issue "were committed to the agency's care by statute";

(2) whether the agency's decision "represents a reasonable accommodation of conflicting policies"; and

(3) whether that accommodation is "not one that Congress would have sanctioned."

As demonstrated below, the FCC's adoption of more accurate depreciation procedures furthers federal policies favoring plant modernization and efficiency, which were committed to the FCC's care by the Communications Act.[3] Second, in applying the revised depreciation procedures to both interstate and intrastate capital assets, the FCC reasonably balanced the short-term benefits of lower depreciation expenses against the possibly disastrous long-term costs of outdated plant and vastly overstated book values. Third, the preemption of intrastate depreciation schedules does not violate Congress' reservation to the States of intrastate ratemaking authority. Indeed, the legislative history of Section 220 of the Act[4] indicates that Congress specifically left open the alternative of federal preemption by rejecting an amendment that would have forbidden the preemption of state depreciation policies.

II. The Communications Act Committed to the FCC's Care Policies Promoting Modernization and Efficient Use of Technology, Which Are Implemented through Capital Recovery Procedures.

Depreciation procedures determine the rate of recovery of capital investment, and are thus crucial to setting the rate of replacement of facilities which continue to function but have become obsolete. Stretched-out depreciation discourages replacement of outdated facilities, while properly-timed capital recovery allows modernization of the network at an appropriate pace, resulting in a more efficient system at a lower overall cost to society.

The FCC depreciation rules at issue in this case seek to implement goals of modernization and efficiency that were specifically entrusted to the FCC by the Communications Act. 47 U.S.C. §§ 151 and 157 (1982). Section 151 directs the FCC to take steps "to make available . . . a rapid, efficient, Nation--

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[3] 47 U.S.C. § 151 (1982) and 47 U.S.C. § 157 (Supp. I 1983). Section 151 of Title 47 was originally Section 1 of the Act. For simplicity's sake, reference to all sections of the Act will use the Title 47 section number.

[4] 47 U.S.C. § 220 (1982).

wide . . . communication service with adequate facilities. . . ." The terms "rapid", "efficient", and "adequate facilities", reflect Congress' desire that communications facilities not be allowed to become outdated and that telephone plant be adequate to keep pace with technological and economic developments.

In order to ensure a reasonable rate of investment so that telephone plant does not become obsolete, Congress empowered the FCC to control the rate of capital investment through the setting of depreciation schedules. Section 220 grants the FCC authority over depreciation requirements, and does not restrict its power to preempt contrary state rules.[5] Depreciation authority is essential to achievement of the broad purpose of Section 151—adequate facilities for rapid and efficient service.

Section 157, enacted in 1983, specifically reaffirms the federal policy of modernization,[6] and recognizes the rapid pace of technological development in the industry:[7]

> It shall be the policy of the United States to encourage the provision of new technologies and services to the public.

[5]*See infra* pp. 23-25.

[6]The House Report describes Congress' intent in enacting Section 157 as follows:

> The Committee has long encouraged the FCC to foster the delivery of new services and new technologies to the public in order to increase competition and promote diversity. Development of new electronic technologies and services has been, and will continue to be, a significant factor in creating jobs and providing U.S. leadership in the new world information era.

H.R. Rep. No. 356, 98th Cong., 1st Sess. 6 (1983).

[7]Although Section 157 was not passed until December 8, 1983, after oral argument before the Fourth Circuit, the amendment simply codified the FCC's policy for over a decade to encourage new technologies and services and to ensure adequate modernization. *E.g., New York State Comm'n on Cable Television v. FCC*, 669 F.2d 58 (2d Cir. 1982); *In re Cox Cable Communications, Inc.*, 50 Fed. Reg. 37, 426 (1985) ("Cox Cable"); *In re Amendment of Parts 2, 21, 87 and 90 of the Commission's Rules*, 86 F.C.C.2d 360 (1981) ("DTS"); The Fourth Circuit apparently did not consider the effect of this amendment in affirming the FCC's preemption order.

47 U.S.C § 157 (Supp. I 1983)

Telecommunications technology has changed rapidly in recent years due to developments such as the widespread use of microwave radio to replace traditional copper telephone wire, the invention and deployment of fiber optic cable, the transition from analog to digital networks, the increased capability of transmission media to send large amounts of data at extremely high speeds, and the implementation of more efficient methods for using the radio spectrum.[8] New technologies or new applications used to transmit voice and data communications include digital termination systems (DTS)[9], coaxial cable[10] and

[8]One area that has shown dramatic technological advances in the past 20 years is switching techniques. Switching technology has progressed from manual to dial to "touch tone," from electromechanical equipment to several generations of electronic switches. The digital switching equipment available today enables companies to offer a greater range of services and produces considerable cost savings. Unfortunately, the rate of electronic conversion has varied among the states, due in part to local regulatory policies. W. Bolter and D. Irwin, *Depreciation Reform: A Crucial Step in Transforming Telecommunications to a Free Market* 41-70 (1980) ("Bolter"); *see generally*, J. Martin, *Future Developments in Telecommunications* (1977).

[9]A Digital Termination System (DTS) is a high-speed digital microwave service designed for users with heavy data traffic. A DTS system consists of a transmitter/receiver station and several customer premise stations. Customers share the same frequency on a time-division basis. A central transmitter sends out a continuous stream of data in all directions, and each user extracts the data specifically addressed to it. DTS can be used to transmit digital data at speeds from 9.6 Kbps up to 1.544 Mbps, and at greater accuracy than traditional analog facilities. It can also be used for digitized voice, facsimile and video conferencing. J. Martin, *Future Developments in Telecommunications* 45-55 (1977). In *In re Amendment of Parts 2, 21, 87 and 90 of the Commission's Rules*, 86 F.C.C.2d 360, 390 (1981), the FCC preempted "inconsistent state regulation of technical standards, market entry standards, and rates and tariff regulations of all carriers using DTS facilities."

[10]Many coaxial cable networks constructed since 1972 for video entertainment have included two-way transmission capabilities to allow for voice and data communications. Coaxial cable has broadband capacity that permits the simultaneous transmission of large volumes of voice, data, facsimile and video communications over a single line. In addition to voice and high-speed data transmission, coaxial cable systems can be used for two-way educational

optical fiber.[11]

Moreover, the simultaneous growth of the computer and electronics industries has allowed businesses and consumers to process and store vast amounts of information. The need to link computer terminals and to transmit large amounts of information conveniently over telephone lines places pressure on telephone companies to provide a range of services in addition to "plain old telephone service."[12] Telephone companies must therefore keep abreast of rapidly advancing technological developments to ensure that their facilities are minimally adequate.[13]

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instruction, home banking, data-base access, home shopping services, energy monitoring, and fire and security systems. E. Noam, *Telecommunications Regulation Today and Tomorrow* 362, 383 (1983). In *Cox Cable*, at ¶ 40, the FCC held that "state regulation of institutional services offered by cable companies that acts as a *de facto* or *de jure* barrier to entry into the interstate communications market or to the provision of interstate communications must be preempted."

[11]Fiber optics is a new technology which allows vast amounts of information to be transmitted along thin glass fibers using light as a medium. This contrasts with conventional systems which transmit electrical current along metal cable. In optical fiber systems, photons of light are directed from a light source through a glass fiber to a light detector. The glass fiber is a fine strand of ultrapure glass weighing only one ounce per kilometer; it may be as thin as a human hair. Two-way communications systems utilize pairs of optical fibers, with each fiber carrying light pulses in one direction only. A pair of glass fibers has transmission capability equivalent to thousands of voice/data circuits. Fiber optic trunking systems have already been constructed in many large cities, including New York City and Washington, D.C. Examples include MCI's fiber optic link between Washington, D.C. and New York City and the Teleport system (*see infra* note 14). J. Martin, *Future Developments in Telecommunications* 455-63 (1977).

[12]J. Martin, *Future Developments in Telecommunications* 3-7, 27-42, 313-25 (1977).

[13]For example, while rotary dial telephone service was at one time standard, "Touchtone" service has recently become widely accepted and demanded by many customers. Because special equipment in the telephone company central office is needed to interpret the tones, the existing equipment in some exchanges is unable to transmit tones and must be updated before the service can be offered. J. Martin, *Telecommunications and the Computer* 410 (1976).

Furthermore, the development and deployment of alternatives to traditional copper wire telephone lines have increased the opportunities for competitors to provide communications service at lower cost or with innovative features.[14] Competition has in turn spurred technological development, as demonstrated by the wide range of Customer Premises Equipment ("CPE") (*e.g.*, telephone instruments) offered by competitors since the introduction of competition in the provision of CPE and the removal of CPE from the telephone companies' rate base.[15] The experience with CPE supports the FCC's finding that technological innovation and a competitive market are the best way to ensure an efficient communications network.

Although unable to predict specific technological developments, Congress entrusted the FCC with promoting modernization and efficiency and encouraging the provision of new technologies and services. Congress provided the Commission with sufficient flexibility to achieve this goal through its regulation of depreciation practices. Modernization of telephone com-

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[14]An example of a communications system employing newer technology, offered by a vendor other than a local telephone company, is the Teleport system in New York. "The Teleport is a planned satellite communications center/office park complex which will offer wide band communications facilities linked to satellite earth stations [in] Staten Island . . . . In addition to [the] Staten Island facilities, Teleport Communications will offer service over a fiber optic network interconnecting points in New York City and nearby New Jersey with the Teleport site. This fiber optic grid will afford access to the satellite stations as well as a means of communication among user installations at the Teleport and at other locations in the area. It is intended that the Teleport serve as a communications gateway between the New York City metropolitan region and the rest of the nation and world." New York State Public Service Commission Case 28710, *Proceeding as to the Provision of Telephone Services that Bypass Local Exchange or Toll Networks*, Testimony of Rosario P. Romanelli of Teleport Communications (April 30, 1984).

[15]*North Carolina Util. Comm'n v. FCC*, 537 F.2d 787 (4th Cir.), *cert. denied*, 429 U.S. 1027 (1976); *North Carolina Util. Comm'n v. FCC*, 552 F.2d 1036 (4th Cir.), *cert. denied*, 434 U.S. 874 (1977); *Computer and Communications Indus. Ass'n v. FCC*, 693 F.2d 198 (D.C. Cir. 1982), *cert. denied*, 461 U.S. 938 (1983).

pany facilities through investment in new technologies — so that service can be provided more efficiently and new services can be added — falls squarely within the policies committed to the FCC by Congress, the first prong of the *de la Cuesta* test.

III. The FCC's Decision Represents a Reasonable Accommodation between the Need to Prevent Obsolete Telephone Plant and Short-Term Increases in Current Depreciation Expenses.

The FCC has reasonably determined (1) that more accurate depreciation policies are essential to ensure adequate, modernized facilities and to encourage efficiency, and (2) that this federal goal cannot be achieved unless the FCC's depreciation changes are applied to both interstate and intrastate property.

Dramatic technological and economic changes since 1960 forced the FCC to reexamine its traditional depreciation rules, which were designed for a monopoly market with a relatively slow rate of technical innovation. Before the advent of competition in the telephone industry, the dominant carrier (AT&T) could control the pace of innovation because it was insulated from market pressures to adopt new technologies and services. During this period, technical innovation was relatively slow.[16] Regulators could keep rates low by agreeing to stretched-out periods for recovering capital investment, which minimized present expenses and deferred depreciation costs to future years. In effect, depreciation became divorced from the actual use of assets, resulting in depreciation of dollars rather than physical assets. Company books overstated the true value of the company's assets as depreciation expenses failed to reflect adequately the actual consumption of assets. The economic inefficiencies, which developed as book value diverged from true value, were simply not a pressing problem in a monopolistic environment.

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[16] *In re Amendment of Part 31, Uniform System of Accounts for Class A and Class B Telephone Companies*, 83 F.C.C.2d 267, 281 (1980); Bolter at B-4.

Because of the way that a rate base-regulated company earns its profits, telephone companies also benefited from deferred depreciation. Through its rates, a regulated utility recovers both operating expenses and allowed earnings on investment, based upon the size of its rate base.[17] When first acquired, a capital asset becomes part of the company's rate base. As it is depreciated, annual depreciation is treated as an operating expense, and the rate base is reduced by a like amount. This in turn reduces allowed earnings on investment, which are calculated by applying a rate of return to the (now diminished) rate base. Depreciation at faster rates therefore increases current operating expenses (for which the company receives only reimbursement) and decreases the rate base (which is the basis for calculating the company's allowable earnings).[18] When depreciation is deferred, the telephone company earns the allowed rate of return on underdepreciated (*i.e.*, overvalued) capital assets.[19]

As long as telephone companies could be shielded from competitive pressures to adopt technological innovations, stretched-out depreciation schedules served the short-term interests of regulators, telephone company shareholders, and ratepayers. Regulation, rather than technology, effectively controlled — and slowed — the introduction of new plant and equipment. Rapid technological development, which opened the door to competition, curtailed regulators' ability to main-

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[17]Rate base rate-of-return regulation traditionally applied to telephone companies requires rates to be set at levels that generate revenues sufficient to cover (1) annual operating expenses — including an annual depreciation charge to recover the company's investment in assets as they are used — and (2) a return on investment. The return on investment is calculated as a percentage of the rate base (which does not include operating expenses). *See generally* 1 A. Kahn, *The Economics of Regulation* (1970).

[18]Of course, if a company were to obtain new capital assets to replace depreciated assets, then investments in new technology could produce a net increase in the total rate base.

[19]*See* NTIA Special Publication 85-16, *Issues in Domestic Telecommunications: Directives for National Policy* 137 (July 1985).

tain these policies, as the increasing availability of lower cost production technologies and customer demand for innovative services placed practical limits upon the economic life and value of older equipment.

The Commission recognized that continued adherence to traditional slow depreciation policies would lead to a growing divergence between the book value of telephone plant and its true economic value. *In re Amendment of Part 31, Uniform System of Accounts for Class A and Class B Telephone Companies*, 83 F.C.C.2d 267 (1980). The company's shareholders would then run the risk of not receiving adequate compensation through depreciation reserves for the loss in economic value, and the cost of capital for these companies would increase as investors perceived the companies as poor risks.[20] 83 F.C.C.2d at 272. Modernization efforts would be hindered, resulting in less efficient plant.[21] Something eventually would have to be

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[20]When an asset is taken out of service before it has been fully depreciated, it receives the same accounting treatment as if it had been fully depreciated. The net rate base is *not* decreased to reflect the asset's retirement, even though insufficient depreciation was taken. 47 C.F.R. § 31.2-25 (1984). This leads to an overstatement of net investment (*i.e.*, actual book value). The resulting difference between book value and actual economic value has been termed "phantom costs." Bolter at 98-99. Ratepayers in future years are forced to pay this depreciation shortfall. As the depreciation deficiencies grow, telephone company managers are reluctant to assume more "phantom costs," which will cause further divergence of book value from economic value. The possibility that regulators may force the company to write off the "phantom costs" and the pressure from competitive alternatives (based on actual costs) place the company's recovery of "phantom costs" at risk. As the market perceives the increased level of risk, the company's cost of capital increases, adversely affecting its ability to obtain funds for construction of newer facilities.

[21]In addition, those customers with heavy usage who can afford to obtain services which use more up-to-date technology and are tailored to their specifications may turn to suppliers other than the telephone company. Smaller users who do not have enough communications usage to justify their own systems are left to cover much of a largely fixed revenue requirement, with a resulting increase in rates for all remaining customers. *See National Ass'n of Regulatory Util. Comm'rs v. FCC*, 737 F.2d 1095, 1116-17 (D.C. Cir. 1984), *cert. denied*, 105 S.Ct 1224 (1985).

done to avoid obsolescence of the telephone network and the need to upgrade it at great cost to ratepayers, shareholders, or both. 1 A. Kahn, *The Economics of Regulation* 117-22 (1970).[22]

The FCC sought to address the "modernization problem" through three changes in depreciation procedures. First, the FCC replaced the traditional depreciation procedure, the vintage group method, with the more accurate equal life group method. 83 F.C.C.2d 267 (1980). Under vintage grouping, all types of equipment installed during one year are grouped together (regardless of their varying life expectancies) and depreciated over the average life of the group.[23] Under equal life grouping, equipment is divided into smaller subgroups so that all items in a subgroup have the same approximate life expectancy.[24] Each subgroup is then assigned its own depreciation schedule, resulting in capital recovery more closely tied to actual useful life.

The FCC explained that "technological trends suggest an increasingly dynamic environment for telecommunications. . . . [I]f the public is to realize the benefits of [technological] advances . . . it is necessary that accounting and depreciation rules not stifle innovation and inhibit the introduction of new technology." *Id.* at 281. The FCC directly addressed the tension between maintaining an efficient, modern

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[22]The FCC carefully considered whether the company's shareholders or its ratepayers should bear the risks of the technological changes which caused inadequate depreciation reserves. It concluded that, as a matter of established regulatory law, ratepayers were responsible for such deficiencies. *Democratic Cent. Comm. v. Washington Metropolitan Area Transit Comm'n*, 485 F.2d 786 (D.C. Cir. 1973), *discussed in* 83 F.C.C.2d at 275-77, *cert. denied sub nom. D.C. Transit Sys., Inc. v. Democratic Cent. Comm.*, 415 U.S. 935 (1974).

[23]Because depreciating each item of equipment individually is impractical, telephone equipment is placed in groups for depreciation purposes.

[24]For example, under vintage grouping, all telephone cable installed in one year is depreciated at the same rate. Under equal life grouping, indoor cable would be depreciated at a different rate from underground cable because of their different life expectancies.

network and keeping depreciation expenses low in the short-term:

> The seeming attraction of stretching out lives to hold down depreciation expenses may impose longer-term costs on our society that far out weigh the short-term advantages. Although [Equal Life Grouping] is likely to result in an increase in the near term in revenue requirements, we believe that the relative size of the increment will be repaid many times over in future years as the ability of regulated telephone companies to continue to provide ". . . rapid, efficient . . . communication service with adequate facilities at reasonable charges is enhanced."

Id. at 281.

Second, the Commission adopted the remaining life method for correcting errors in the forecasts of the useful life of assets in place of the whole life method. The whole life method requires calculation of annual depreciation as if the whole life of an asset was correctly estimated from the start, even if it becomes clear at a later time that the initial estimate was wrong. The remaining life method allows the carrier to correct useful life estimates by allocating any unrecovered depreciation over the more accurate remaining life.[25]

Again, the FCC cited "the impact of new technology and the transition from a monopoly to a competitive environment [which] have led to an overall shortening of life estimates," not anticipated when depreciation rates were originally set. Without future corrective action, the depreciation deficiencies

[25]For example, the original estimated useful life of an asset may be 10 years with 10% depreciation taken each year. By the end of the second year, 20% of the capital investment would have been depreciated. Technological developments may then make it clear that the useful life of the asset is five rather than ten years. Under the whole life method, the annual depreciation would be revised to 20% for the third, fourth and fifth years, for a total depreciation for this asset of 80%. Under the remaining life method, depreciation for the third, fourth and fifth years would be approximately 26.7% so that 100% of the costs of the asset would be recovered at the end of five years.

would continue to grow. *Id.* at 290. A corrective mechanism would help the companies "to measure as accurately as possible the consumption of capital in a capital intensive enterprise." *Id.* at 288.[26]

Third, the FCC ordered that inside wiring, which had been capitalized and depreciated, be treated instead as a current expense. *In re Amendment of Part 31, Uniform System of Accounts for Class A and Class B Telephone Companies*, 85 F.C.C.2d 818, 827 (1981).[27] This change gave effect to FCC policies that capital recovery should be tied to the actual use of assets and that cost burdens should not be borne by future ratepayers who do not benefit from the expenditure. Because the costs of inside wiring are "dictated and governed by the [customer's] selection and placement of terminal equipment," and the "service life and location costs are generated and controlled by individual customers' decisions," the costs should be borne by the current ratepayers who use the inside wiring, rather than future ratepayers. *Id.* at 827.[28]

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[26]The FCC allowed telephone companies the option of adopting the equal life group or the remaining life approaches, assuming that the companies could best determine the state of their equipment and the need for modernization. *In re Amendment of Part 31*, 83 F.C.C.2d at 293.

[27]Inside wiring is the cost of installing wiring for telephone or telecommunications services inside the premises of a business or residence. Recently, companies offering CPE have begun to install the wiring themselves in connection with their provision of CPE. *Id.*

[28]The FCC recognized that the optimal solution was to detariff inside wiring and thus place the costs on the immediate customer who actually ordered, and thus caused, the expenditure. With the growth of competition in the provision of station connections, including the provision of inside wire, the FCC was forced to reconsider whether inside wiring costs should continue to be charged to the general body of ratepayers through capitalization and depreciation. Customers who obtained station connections from sources other than the telephone company would otherwise have to pay telephone rates that included depreciation and a return on investment attributable to the telephone company's provision of station connections for other customers. *Id.* at 827; *Computer and Communications Indus. Ass'n v. FCC*, 693 F.2d 198 (D.C. Cir. 1982), *cert denied*, 461 U.S. 938 (1983). The FCC concluded that it would defer taking the step of ordering detariffing, and begin by

The equal life grouping method, the remaining life method, and the expensing of inside wiring were reasonable approaches by the FCC to the problems of growing depreciation reserve deficiencies and disincentives to modernize. The new depreciation procedures reflect more accurately the actual use of assets, allow mid-course corrections to erroneous life estimates, and remove some of the burden of current costs from future ratepayers.[29]

Once it is accepted that the FCC acted reasonably in adopting depreciation procedures that implement the statutorily-established policies of modernization and efficiency, there is little question that preemption of inconsistent state regulations is appropriate, indeed essential. Because telephone plant is used interchangeably for interstate and intrastate communications, procedures outlined in the Separations Manual must be used to allocate the costs of the plant between the jurisdictions.[30] Currently, approximately 25% of non-usage-sensitive

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placing the burden on "all customers at the time the expenditures were made (as opposed to present and future customers when the costs are capitalized). . . . Thus, while our ultimate goal is to see that this burden is placed on the cost causative customer, the continued strict adherence to full capitalization will continue to permit this problem to grow. This is a situation which we believe is unacceptable." 85 F.C.C. 2d at 828.

[29]Predicting the useful life of any asset is inherently imprecise and relies heavily upon the agency's engineering, technical and economic expertise and its reasoned judgment. Fixing depreciation rates requires the agency to forecast the useful lives of different types of assets, which in turn depends upon predictions of technological developments in the industry. The FCC must also consider social policy issues, including the effect of increased depreciation expenses on intrastate revenue requirements and the agency's statutory duty to ensure an efficient network and to encourage new technology. The agency's decision to change depreciation procedures and adopt corrective measures should therefore be accorded considerable deference. *Smith v. Illinois Bell Tel. Co.*, 282 U.S. 133 (1930). No party sought judicial review of either of the FCC's orders on depreciation underlying the preemption decision.

[30]*Smith v. Illinois Bell Tel. Co.*, 282 U.S. 133, 149 (1930), held that a state commission could not set rates based on total telephone company plant, without some apportionment of costs between the intrastate and interstate

plant and roughly 10% of usage-sensitive plant are allocated to the interstate jurisdiction. If the FCC were to impose its depreciation changes on at most 25% of the separated plant costs, and the States continued to follow slower depreciation schedules to keep current rates low, the FCC's actions would have little impact on capital investment decisions.

A businessman deciding to retire older assets used for both interstate and intrastate service does not distinguish between interstate and intrastate depreciation. It is impossible to replace the "interstate portion" of the asset, which may have been fully depreciated, without also replacing the "intrastate portion" of the asset, which may not have been fully depreciated. The decision to replace equipment that serves both jurisdictions inevitably turns on the *total* amount of unrecovered investment, taking into account both intrastate and interstate depreciation schedules. The effect of intrastate depreciation policies is thus truly "inseparable" from the effect of interstate depreciation policies in influencing the economic decision to retire and replace obsolete equipment.

This "inseparability" brings the present case squarely within a line of court of appeals decisions authorizing FCC preemption based upon "inseparability." In *North Carolina Utilities Commission v. FCC*, 537 F.2d 787 (4th Cir.), *cert. denied*, 429 U.S. 1027 (1976), the Fourth Circuit upheld the FCC's preemption of

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jurisdictions. Although *Smith* did not mandate apportionment based on usage, the system of allocation that has grown out of *Smith* divides plant costs by comparing interstate and intrastate usage. *National Ass'n of Regulatory Util. Comm'rs v. FCC*, 737 F.2d 1095, 1113 (D.C. Cir. 1984), *cert. denied*, 105 S.Ct 1224 (1985). The elaborate procedures for jurisdictional allocations of costs are contained in the so-called Separations Manual, and the regulations implementing it. 47 C.F.R. Part 67 (1984). In 1971, Congress amended the Communications Act to add Section 410, establishing a Joint Board composed of state and federal representatives, to provide recommendations to the FCC regarding, *inter alia*, "jurisdictional separation of common carrier property and expenses between interstate and intrastate operations." 47 U.S.C. § 410(c) (1982). Changes to the Separations Manual are reviewed by the Joint Board, and the FCC may then adopt or reject the Joint Board's recommendations.

state regulations prohibiting the interconnection of customer premises equipment used to place both interstate and intrastate calls. The court agreed with the FCC that "[u]sually, it is not *feasible as a matter of economics* and *practicality of operation*, to limit the use of such equipment to either interstate or intrastate transmissions." 537 F.2d at 791 (emphasis added). It concluded that the intrastate jurisdiction under 47 U.S.C. § 152(b) (1982)[31] extended only to those facilities "separable from and . . . not substantially affect[ing] the conduct or development of interstate communications." The "inseparability" factor has been cited in a number of other cases upholding the FCC's preemptive authority. *E.g.*, *National Association of Regulatory Utility Commissioners v. FCC*, 746 F.2d 1492 (D.C. Cir. 1984); *California v. FCC*, 567 F.2d 84 (D.C. Cir. 1977), *cert. denied*, 434 U.S. 1010 (1978); *Puerto Rico Telephone Co. v. FCC*, 553 F.2d 694, 700 (1st Cir. 1977); *North Carolina Utilities Commission v. FCC*, 552 F.2d 1036 (4th Cir), *cert. denied*, 434 U.S. 874 (1977).

"Inseparability," although important, is only one of several factors to be considered in deciding whether state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress," *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941). State depreciation policies, in addition to blocking federal objectives, may place unfair burdens upon interstate ratepayers due to the operation of the Separations process. The FCC noted that "[T]he utilization of one depreciation rate is the most effective method for insuring that . . . no jurisdiction bears a greater burden than another . . . . [S]ignificant inequities would [otherwise] result to both ratepayers and carriers."[32] *In re Amendment of Part 31, Uniform System*

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[31]*See infra* pp. 25-27.

[32]For example, assume an initial investment of $100,000 in non-usage-sensitive plant. Separations initially assigns approximately $25,000 of the $100,000 asset to the interstate jurisdiction and $75,000 to the intrastate jurisdiction. Federal depreciation procedures adopt a more accurate five-year life while state procedures retain a ten-year life. After the first year of depreciation, the remaining interstate costs will be $20,000, and the remain-

of Accounts for Class A and Class B Telephone Companies, 92 F.C.C.2d 864 (1983).

The FCC has recognized that state regulations "would obstruct the accomplishment and execution of the full purposes of Congress." *Id.* at 868. The provision for adequate capital recovery is important to achieve the purpose of Congress for the provision of a "rapid, efficient, Nation-wide" service. *Id.* at 876. "State depreciation rate prescriptions . . . do not adequately provide for capital recovery in the competitive environment, [and] in an increasingly competitive environment, it is possible that *improper capital recovery could delay or prevent modernization which would add to the costs borne by ratepayers* and could, ultimately, threaten carriers' ability to fully recover their invested capital." *Id.* at 877 (emphasis added). The Commission considered the possible effect on increased intrastate revenue requirements[33] but reached a reasonable accommodation in deciding that the advancement of federal goals requires preemption to preclude the higher long-term costs (both interstate and intrastate) of outdated networks and financially weakened telephone companies.

In sum, the valid federal objectives of modernization and efficiency *simply cannot be achieved* without preempting state

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ing intrastate costs will be $67,500, for a total of $87,500. In the second year, the total costs of $87,500 are separated to allocate 25% (or $21,875) to the interstate jurisdiction and 75% (or $65,625) to the intrastate jurisdiction. Had the state followed the federal five-year life, only $20,000 would have been allocated to the interstate jurisdiction. Thus, unless a state adopts federal procedures, interstate customers are effectively penalized by paying more than their share of separated costs over time—simply because the FCC has used more accurate depreciation procedures.

[33]State interests to be considered are the state's general interest in protecting its ratemaking authority under Section 152(b) and its specific interest in keeping intrastate depreciation expenses and revenue requirements low in the short-term. The FCC weighed the short-term benefits of lower depreciation expenses against the long-term costs of inefficient and obsolete plant, and concluded that more accurate depreciation procedures were essential, even if expenses would increase in the short-term. *See supra* p. 15. The States' ratemaking authority under Section 152(b) is discussed *infra* pp. 25-29.

regulations which create substantial disincentives to the replacement of obsolete but underdepreciated assets. In order to ensure a rapid, efficient network with adequate facilities, the FCC properly overrode the States' short-term interest in avoiding increased depreciation expenses, thus meeting the second prong of the *de la Cuesta* test.[34]

IV. The FCC's Preemption of State Depreciation Rules Does Not Fall within Section 152(b)'s Reservation of State Authority.

The final prong of the *de la Cuesta* test states:

> [W]e should not disturb [a preemption decision] *unless* it appears from the statute or the legislative history that *the accommodation is not one that Congress would have sanctioned.*

458 U.S. at 154 (emphasis added). Stated differently, assuming the other elements of the test are met, this Court will uphold an agency's preemption decision in the absence of a showing that Congress would have disapproved of such a result.

Section 2(b) of the Act, 47 U.S.C. § 152(b) (1982), does not indicate that Congress would have disapproved of federal preemption of state depreciation procedures. The imposition of federal depreciation rules does not fall within the prohibition of that Section:

> [S]ubject to the provisions of section 301 of this title . . . nothing in this chapter shall be construed to apply or to give the Commission jurisdiction with respect to . . . charges, classifications, practices, services, facilities, or

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[34]The Fourth Circuit reviewed the FCC's actions under the *de la Cuesta* test and concluded that the FCC had acted "within its authority to ensure efficient operation of the interstate network." Recognizing that usually at least 75% of investment in new plant is intrastate, the court explained that "[i]f that large amount of equipment investment should fail properly to reflect its true, rapid depreciation, *interstate service would then suffer the effects of delayed innovation.*" *Virginia State Corp. Comm'n v. FCC*, 737 F.2d 388, 395 (emphasis added).

> regulations for or in connection with intrastate communication service by wire or radio of any carrier. . . .

Although Section 152(b) indicates that Congress did not intend to displace *all* state communications regulation, it is necessary to examine other provisions of the Act and its legislative history to determine (1) whether Congress intended to include depreciation procedures within the area reserved to the States; and (2) whether Section 152(b) should be read narrowly or broadly in the event of a jurisdictional conflict.

In fact, Congress specifically rejected an amendment, urged by the States, which would have precluded federal preemption of state depreciation rules by reserving to the States the authority to prescribe depreciation rates. And Sections 151 and 153, which establish the FCC's sweeping mandate and broadly define the interstate jurisdiction, support a narrow reading of the States' authority under Section 152(b).

A. Congress Specifically Rejected an Amendment to Section 220 That Would Have Prohibited Preemption.

Section 220 of the Act reflects Congress' intent to establish a uniform depreciation system for the capital recovery of assets used jointly in both jurisdictions. Section 220(b) provides that the FCC "shall" prescribe depreciation charges for carriers under the Act and prohibits carriers from depreciating any property, or using any rate of depreciation, other than that adopted by the FCC.[35] Subsections (b) through (g) of Section 220 are identical to the depreciation provisions in the Interstate Commerce Act, which by 1934 had been interpreted to give the Interstate Commerce Commission authority to preempt state depreciation charges.[36]

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[35] In contrast, Section 220(a) states that "[t]he Commission may, in its discretion, prescribe the forms of any and all accounts." 47 U.S.C. § 220(a) (1982). Congress thus clearly distinguished between the FCC's discretionary authority to set up a uniform accounting system and its mandatory duty to establish uniform depreciation procedures.

[36] *Depreciation Charges of Telephone Companies and Depreciation Charges of Steam Railroad Companies*, decided together at 118 I.C.C. 295, 328-33 (1926), *further proceedings*, 177 I.C.C. 351 (1931).

During the hearings on what became the Communications Act of 1934, the States objected that modeling the FCC's depreciation section after the Interstate Commerce Act would allow the FCC to preempt State depreciation schedules and proposed an amendment which would have removed intrastate depreciation from the FCC's authority.[37] The amendment would have reserved to the States authority "to prescribe, for purposes of the exercise of its jurisdiction with respect to any carrier, the percentage rate of depreciation."[38] The Senate refused to adopt the States' amendment, however, and the Interstate Commerce Act version of the section was ultimately adopted, confirming the agency's preemptive power over depreciation.[39]

Congress took the States' concerns into account by requiring the FCC to give notice to the States before prescribing any requirements and to afford each state commission an opportunity to present its "views and recommendations." Congress also allowed the FCC to except certain carriers from Section 220's requirements — "consistent with the public interest" — "where such carriers are subject to state commission regulation." 47 U.S.C. § 220(h) (1982). Congress contemplated that the Commission would first prepare a report on federal-state relations before any further legislative action was taken to strengthen the States' authority. 47 U.S.C. § 220(j) (1982).

Congress may in fact have intended in Section 220 to remove *all* state authority to set depreciation rules. *Amendment of Part 31, Uniform System of Accounts for Class A and Class B Telephone Companies*, 92 F.C.C.2d 864, 867 (1983). But the *de la Cuesta* preemption test does not require such a showing. This Court need only consider that, after full consideration of the issue by both Houses, the 1934 Congress refused to adopt

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[37] *Hearings on S. 2910 Before the Senate Committee on Interstate Commerce*, 73d Cong., 2d Sess. 181 (1934) (statement on behalf of NARUC).

[38] *See* S. 3285, 73d Cong., 2d Sess. § 220(j), (June 1, 1934) (House Committee Version), *reported in* H.R. Rep. No. 1850, 73d Cong., 2d Sess. 7 (1934).

[39] *See* S. Rep. No. 781, 73d Cong., 2d Sess. 5 (1934); H.R. Rep. No. 1918, 73d Cong., 2d Sess. 47 (1934).

an amendment that would have prohibited the very action challenged by the States today. Instead, Congress enacted a series of provisions that make the FCC's authority in this area clear and demonstrate, at the very least, that Congress did not wish to prevent FCC preemption. The final prong of the *de la Cuesta* test is thus met.

B. Since Most Telephone Plant Is Used for Both Interstate and Intrastate Communications, Section 152(b) Must Be Read Narrowly in Order to Achieve the Purposes of the Act.

The FCC's depreciation decision does not intrude upon Section 152(b)'s reservation of state jurisdiction, which must be read in a manner that makes it consistent with other provisions of the Act. Section 151 confers extensive powers on the FCC "to make available, so far as possible, to all the people of the United States a rapid, efficient, Nation-wide, and world-wide radio and communication service with adequate facilities at reasonable charges." 47 U.S.C. § 151 (1982). Section 153, which grants the FCC's jurisdiction over "interstate communications" or "interstate transmission," defines those terms broadly to include any "communications or transmission . . . from any State . . . to any other State," including all facilities and service "incidental to such transmission." 47 U.S.C. § 153 (1982).

Because telephone plant has always been used jointly for both interstate and intrastate communications,[40] an expansive

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[40]A telephone call — whether interstate or intrastate — originates in the same telephone instrument (CPE) and traverses the same inside wiring and telephone lines to reach the first point of switching, the local telephone company's central office. Prior to the AT&T divestiture, facilities were not configured to handle interstate toll calls differently than intrastate toll calls and this has not changed. Since divestiture, a distinction has been drawn between interLATA and intraLATA calls. A LATA (Local Access and Transport Area) is one of over 150 geographical regions, all larger than a single local exchange, whose boundaries were drawn during the MFJ Consent Decree negotiation process. The Bell Operating Companies ("BOCs") may operate only within a LATA, and thus they carry only local and *intra*LATA

reading of Section 152(b) would contradict the sweeping purposes of the Communications Act. Were Section 152(b) read to allow the Commission "to exercise its jurisdiction only where the telephone facilities in question were exclusively interstate in character, it would result in virtually complete abdication from the field of telephone regulation." *North Carolina Utilities Commission v. FCC*, 537 F.2d at 794, quoting *Katz v. American Telephone and Telegraph Co.*, 43 F.C.C. 1328, 1332 (1943).

The FCC and the lower courts have repeatedly rejected interpretations of Section 152(b) that would deprive the Commission of authority over facilities and equipment used in connection with both interstate and intrastate communications. Section 152(b) should not be interpreted to obstruct "the broad purposes of the Act" and the "comprehensive and pervasive" responsibilities of FCC. "Any other determination would tend to fragment the regulation of a communications activity which cannot be regulated on any realistic basis except by a central authority; fifty states and myriad local authorities cannot effectively deal with bits and pieces of what is really a unified system of communication." *General Telephone Company v. FCC*, 413 F.2d 390, 401 (D.C. Cir.), *cert. denied*, 396 U.S. 888 (1969). Consistent with the goal of a unified system of communication subject to a central authority, lower courts have upheld the FCC's assertion of jurisdiction in such diverse areas as state certification requirements for CPE, (*North Carolina Utilities Commission v. FCC*, 552 F.2d 1036 (4th Cir. 1977); *North Carolina Utilities Commission v. FCC*, 537 F.2d 787 (4th Cir. 1976)); the detariffing of CPE (*Computer and Communication*

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toll calls. Interexchange carriers, such as AT&T Communications and MCI, carry interLATA (and interstate) toll calls. (Some states allow interexchange carriers to carry intraLATA calls as well.) InterLATA calls may be either interstate or intrastate, and intraLATA calls, although primarily intrastate, may also be interstate. Although the BOCs are taking steps to reconfigure their networks to conform to LATA boundaries, they continue to draw no distinction in the use of facilities to handle the local access portions of interstate and intrastate toll calls. *See supra* note 1.

Industry Association v. FCC, 693 F.2d 198 (D.C. Cir. 1982)); intrastate private lines which are part of interstate networks (*National Association of Regulatory Utility Commissioners v. FCC*, 737 F.2d 1095 (D.C. Cir. 1984); *California v. FCC*, 567 F.2d 84 (D.C. Cir. 1977), *cert. denied*, 434 U.S. 1010 (1978)); and state regulation of particular developing technologies (*New York State Commission on Cable Television v. FCC*, 669 F.2d 58 (2d Cir. 1982)). Industry expectations have evolved, and business decisions have been made, in a way that recognizes the coordinated, unified nature of the nation's communications network and the paramount importance of unfettered interstate communications.

Moreover, Congress has not been unaware of the FCC's and the courts' interpretation of Section 152(b). In 1971, it amended the Act by adding the present Section 410(c), dealing with matters of federal-state concern. 47 U.S.C. § 410(c) (1982). That section confers upon the FCC discretionary power to refer any matter "relating to common carrier communications of joint Federal-State concern, to a Federal-State Joint Board." The FCC is required to refer to the Joint Board "any proceeding regarding jurisdictional separation of common carrier property and expenses between interstate and intrastate operations." Joint Board recommendations have no binding effect, however; the Commission alone is authorized to make final decisions. Had Congress believed that the FCC's expansive exercise of federal jurisdiction impinged upon an area reserved to the States, it would have redressed the perceived imbalance, not created a Joint Board empowered only to advise the FCC. *See North Carolina Utilities Commission v. FCC*, 537 F.2d 787, 795.

In 1983, Congress affirmed the FCC's specific policy of encouraging new technologies and services by adding Section 157 to the Act and implicitly approving the FCC's prior preemption of state regulation of developing technologies such as DTS. *In re Amendment of Parts 2, 21, 87 and 90 of the Commission's Rules*, 86 F.C.C.2d 360 (1981).

C. The States Retain Flexibility to Mitigate the Effects of Short-Term Increases in Depreciation Expenses.

While the FCC's preemption decision ensures that more accurately-timed depreciation removes disincentives to modernization, the States retain considerable flexibility in implementing the depreciation changes. The revised depreciation procedures will inevitably result in increased intrastate depreciation expenses, but this phenomenon will last only until the serious problem of depreciation deficiencies is resolved. The FCC decision changes only the timing of capital recovery; it does not increase the total costs to be recovered.

Furthermore, depreciation expenses constitute only one of hundreds of costs that go into the setting of intrastate revenue requirements. Just as the States have the flexibility to make adjustments for increases in equipment manufacturers' costs, they have a range of responses to increased costs from depreciation changes. The States, for example, may adjust rates of return to recognize the decrease in the degree of risk due to corrective measures that bring book value in line with economic value. Even when intrastate revenue requirements increase, the States retain authority to allocate the intrastate portion of these short-term increases among intrastate services. It is possible for the FCC to achieve its goal of removing disincentives to modernization while at the same time leaving the States with substantial ratemaking authority to cushion the impact of increases in depreciation expenses on local rates.

As the Fourth Circuit Court of Appeals noted in addressing a state argument that preemption of CPE would "jeopardize state ratemaking prerogatives to subsidize" local service:

> Political expediency may encourage state commissions to defend their current option to bury subsidy costs in as many holes as possible, but this concern cannot be allowed to determine the allocation of jurisdictional competency between state and federal agencies.

North Carolina Utilities Commission v. FCC, 552 F.2d 1036, 1048. Removal of one option does not curtail the States' flex-

ibility to make adjustments in other areas to ensure continued low rates for local service. The States have many choices, and need not pass all of the increase in depreciation expenses directly to local service customers.

If federal actions were constrained simply because they remove one of many available options from the States' grasp, the FCC would be essentially powerless to ensure a rapid, efficient, nationwide network. If Section 152(b) were to prohibit any federal action that affects a source of subsidy for local service or that increases intrastate revenue requirements, interstate regulation would become a nullity. That would clearly defeat Congress' goal of a unified and efficient nationwide communications network with adequate facilities.

CONCLUSION

This Court should affirm the Fourth Circuit's decision upholding the FCC's preemption of state depreciation procedures which frustrate the federal objectives of modernization and efficiency. Review is limited to the elements prescribed in this Court's preemption test in *de la Cuesta*, and, as demonstrated above, each of these elements has been met.

Respectfully submitted,

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